6/22/81

Financial Markets

Irving Trust

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B 4750-1

Friday (Noon) June 12, 1981

This week, financial markets were essentially a dealer phenomenom, with little participation from retail investors. The rally of recent weeks was fed this week by the continued sluggish behavior of money stock data as well as the sharply lower drift of the rate on Federal funds after the weekend. That prop began to falter, however, after the Federal Reserve's repeated efforts to drain reserves resulted in the funds rate shooting up well above 20% Wednesday afternoon and subsequently trading in the 18%-19% area. In that setting, even Thursday's report on May retail sales data--pointing to continued sluggishness in that sector--could not prompt a meaningful decline in rates.

Since the postweekend softness in the funds rate probably reflected a technical problem affecting reserve availability--as evidenced by the Fed's repeated draining of reserves--there is at this time no tangible evidence of any overt move toward ease by the Fed. All that seems to have happened in the last several weeks is a slight easing of pressure on bank reserves positions due to sluggish M-1B growth during the period. That is what one would expect under the Fed's reserves-oriented operating procedures.

Probably any overt attempt by the Fed to speed up reserves provision will have to wait at least until the FOMC meeting scheduled for July 7. In the first place, it appears highly likely that the Committee staff is still projecting a resurgence of money growth following the abnormally sluggish behavior of money demand in the first quarter of this year. In addition, we know from the FOMC minutes that more weight than previously is being given to M-2--and that aggregate remains near the top of its target range, though the recent weak performance of money market mutual fund shares should improve the situation temporarily. Finally, the FOMC earlier this year expressed a preference for money growth in the lower part of the target ranges as a counter for the above-target growth noted late last year. Another possible motive for the same cautious approach is that the stimulative impact of whatever tax cut Congress passes will likely begin sometime in the second half of the year, raising the question of whether the Fed might encounter a late-year surge in money demand akin to last year's. There is no disputing the political embarrassment that would follow the Fed's missing its money targets (however slightly) for a second year in a row due to a late surge.

If these considerations--or others like them--impel the Fed to resist any overt move toward ease until July, there could be some near-term trouble for the financial markets. As noted here last week, the rally has proceeded so far now that dealers are faced with truly massive costs of financing their positions. They can live with that for a while, but unless they receive support soon from retail investors and the Fed funds rate, some increases of rates will occur.

William C. Melton

Note: The full text of the letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	6/12/81 (Noon)	Wk. Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.00%	20.00%	12.00%
Effective since	6/2/81		
Discount Rate at Federal Reserve Bank	14.00	14.00	11.00
Federal Funds	18.25	20.25	8.50
Repurchase Agreements	16.50	20.25	8.00
U.S. Treasury Issues			
Bills			
3 months	15.30	16.75	6.25
6 months	15.19	16.25	6.90
1 year	14.68	15.40	7.40
Coupons			
2 years	14.43	14.75	8.20
4 years	14.00	14.35	8.55
7 years	13.55	13.80	8.75
10 years	13.33	13.55	9.40
Long Bond	12.82	13.10	9.48
Negotiable Certificates of Deposit-Secondary Market			
1 month	17.40	18.50	8.25
3 months	16.55	17.85	8.25
6 months	15.75	16.80	8.10
1 year	15.25	16.00	8.00
Banker's Acceptances			
1 month	17.50	19.30	8.25
3 months	16.55	17.75	7.88
6 months	15.75	16.70	8.15
Eurodollar Deposits			
1 month	18.13	19.25	8.69
2 months	17.88	18.75	8.75
3 months	17.63	18.63	8.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	17.50	18.25	8.13
1 month	17.00	17.75	7.75
3 months	16.00	16.00	7.50
Bank Holding Companies			
1 month	17.50	18.50	7.50
Dealer Placed:			
3 months	16.50	18.50	7.75
New AA Corporate Utility Bond	15.75	15.75	11.00
Tax Exempt			
6 month Project Notes	7.00	7.10	3.70
1 year AAA Bond	7.20	7.50	4.60
5 year AAA Bond	8.50	8.25	5.10
20 year AAA Bond	10.10	9.90	6.50

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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